Supreme Court of the United States

OCTOBER TERM 1941

No. [redacted] 137

PRUDENCE REALIZATION CORPORATION,

Petitioner,

vs.

JOSEPH W. FERRIS, GEORGE L. LONG and HENRY LEIFERT as Trustees under a Declaration of Trust dated as of July 1st, 1938, with respect to 307 West 36th Street (Burnside) First Mortgage Participation Certificates, CITY BANK FARMERS TRUST COMPANY and MARTIN S. LINDGROVE as Trustees under the Last Will and Testament of Herman Stutzer, deceased, on behalf of themselves and other holders of certificates in 307 West 36th Street (Burnside) First Mortgage Participation Certificates, SOLOMON ZAUDERER, MILTON KIMMELMAN, IRVING ZAUDERER and CHARLES KIMMELMAN, doing business as KIMMELMAN AND ZAUDERER, on behalf of themselves and all other holders of Prudence Bonds Corporation participating certificate issue, and HUNTER L. DELATOUR, RAYMOND REISLER and JEROME THRALLS, Trustees of Realty Associates Securities Corporation, Debtor, holders of Burnside Certificates.

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF NEW YORK, COUNTY OF NEW YORK

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PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF NEW YORK, COUNTY OF NEW YORK

To the Honorable the Chief Justice of the Supreme Court of the United States of America and the Honorable Associate Justices thereof:

Your petitioner, Prudence Realization Corporation, respectfully submits this, its petition for a writ of certiorari

to review the judgment and order of the Court of Appeals of the State of New York and the judgment entered thereon in the office of the Clerk of the Supreme Court of the State of New York, County of New York, determining that certificates of participation held by Prudence Realization Corporation (hereinafter sometimes described as the creditors' corporation) in a mortgage participation certificate issue covering premises at 307 West 36th Street, New York City, New York, also known as the Burnside Certificate Issue, are subordinated in time of payment of principal and interest to similar certificates of participation held by other certificate holders.

Opinions Below

Written opinions have been rendered by the Additional Special Term Justice (R. 322, not reported), by the Appellate Division, First Department of the Supreme Court of the State of New York, County of New York (R. 340, reported at 266 App. Div. 543), and by the New York Court of Appeals (R. 359, reported at 292 N. Y. 210).

Jurisdiction

The judgment and order of the New York Court of Appeals was entered on March 10, 1944 (R. 345), and the judgment of the Supreme Court, New York County, was entered thereon on April 20, 1944 (R. 351). The jurisdiction of this Court is invoked under Section 237(b) of the Judicial Code, as amended (28 U. S. C. A., Sec. 344(b)).

Questions Presented

The New York Court of Appeals held its own decisions controlling on the question of creditor participation in an

solvent estate which had been reorganized under Section B of the Bankruptcy Act. The property reorganized was al estate and a mortgage thereon, against which partici- tion certificates had been issued. The 77-B Trustees of e insolvent guarantor held some of the certificates. olely to avoid delay in consummating the 77-B Plan for e Certificate Issue, it was amended so as to provide that distribution should be made thereunder upon such cer- ficates until an adjudication was had by a "court of com- tent jurisdiction" of the rights to participation with spect to such certificates. The plan as so amended as confirmed and the reorganization proceeding closed. hereafter, an action was instituted in the New York tate courts wherein the plaintiffs prayed for adjudication f the rights of participation to which the certificates held y the insolvent guarantor were entitled. Petitioner is the reditors' corporation organized pursuant to the plan of eorganization of the bankrupt guarantor and succeeded its rights. Named as a defendant, it demanded judgment ecreeing that it was entitled to parity of treatment with ther certificate holders on the ground that since the Cer- ificate Issue and the Guarantor had been reorganized under Section 77B of the Bankruptcy Act and the question of articipation on account of its certificates had been re- erved in the manner and circumstances above described, uch question was determinable in accordance with federal aw and that under applicable federal decisions its certifi- ates were entitled to parity of treatment with those held by thers. The Appellate Division of the New York Supreme Court unanimously upheld petitioner's view and ordered judgment in its favor on the authority of *Prudence Realiza- tion Corporation* v. *Geist*, 316 U. S. 89 (R. 343). The Court of Appeals reversed, holding that the question of partiy was one of state law and that under local law petitioner's certificates are subordinate to other certificates (R. 359). The principal questions involved are:

1. Did the state court litigation necessarily involve adjudication of substantial title, rights, privileges or immunities specially set up or claimed by petitioner under the Constitution or statutes of the United States?

2. In construing the provisions of a Plan adopted in a reorganization proceeding under Section 77B of the Bankruptcy Act, was the state court correct in failing to give effect to the provisions of the Bankruptcy Act and the decisions of this court thereunder?

3. Was the state court correct in disregarding the effect of bankruptcy reorganization proceedings for the certificate issue and the guarantor and in applying local law alone in determining the rights of the guarantor's creditors to participate in the proceeds of the certificate issue?

4. Was the state court correct in construing a provision in a federal plan of reorganization not alone as a grant of concurrent jurisdiction to a state court, but as a surrender of creditors' rights under the Bankruptcy Act as well?

Statement

The Prudence Company, Inc., hereafter called "Prudence", was organized under the Banking Law of the State of New York in 1919. It was engaged in the business of making loans secured by mortgages on real estate. The bonds and mortgages received for such loans were assigned to an affiliated corporation, Prudence-Bonds Corporation. In many instances, Prudence-Bonds Corporation transferred these bonds and mortgages to corporate trust companies called depositaries and issued certificates of participation in such mortgages to Prudence which in turn sold them to the general public together with its guaranty of payment of principal and interest. The guaranty of Prudence called for the payment of interest on the certificates

when due and for the payment of principal within eighteen months after maturity (R. 53).

These mortgage participation certificates constituted the holders thereof tenants in common of the underlying mortgage and bond secured thereby (*In re Westover* [C. C. A. 2d], 82 F. [2d] 177).

As part of its business, from time to time Prudence either repurchased some of these certificates from the investing public or received them in exchange for certificates in other mortgages.

Prudence Realization Corporation, the petitioner here, was organized pursuant to a plan of reorganization for Prudence under Section 77B of the Bankruptcy Act (R. 24). The plan was proposed by Reconstruction Finance Corporation, the largest single creditor of Prudence, after a finding had been made that Prudence was insolvent. The plan provides that the stockholders of Prudence have no interest in the liquidation of its assets and provides for the distribution of the proceeds of such liquidation to creditors only (R. 25). Petitioner is therefore a creditors' realization corporation and in no way represents interests of the old stockholders.

The Burnside Certificate Issue was created in the general manner above described. The mortgage originally in the principal sum of $1,200,000 was reduced by payment to $1,016,000. The certificates to the extent of $1,016,000 are presently outstanding (R. 20). Included in the assets of the insolvent Prudence estate transferred to petitioner are $431,212.86 in principal amount of Burnside certificates which were repurchased in the regular course of its business by Prudence during 1932 and 1933 (R. 23, 59). These certificates were included in the corporate assets of Prudence as evidenced by published financial statements and corporate balance sheets prepared by certified public accountants (R. 206).

In January, 1935 an involuntary petition for the reorganization of Prudence under Section 77B of the Bank-

ruptcy Act was filed in the Eastern District Court and on February 1, 1935 the petition, consolidated with the debtor's voluntary petition for reorganization, was approved and trustees appointed. An order was entered in that proceeding prescribing the procedure for the filing of proofs of claim by creditors including certificate holders of the Burnside Certificate Issue who were unsecured creditors of the debtor. In these proofs of claim certificate holders asserted unsecured claims for the full principal and interest due on the Prudence guaranty of the certificates held by them (R. 193, 201) and they were allowed as such.

On March 16, 1936, pursuant to authorization secured in the Prudence proceeding, the petition for reorganization of Amalgamated Properties, Inc., a subsidiary of Prudence, was approved by the Eastern District Court (R. 21). Included among its assets was the real property subject to the Burnside Certificate Issue mortgage, and in that proceeding a plan of reorganization for that issue was proposed which provided for the transfer of the real property by Amalgamated to three trustees appointed for certificate holders who also, pursuant to said plan, acquired the certificated mortgage. The lien of the mortgage was preserved for the benefit of all the certificate holders who also become co-owners of the real estate. That plan of reorganization for the Burnside Issue, as amended, was finally approved by the District Court on June 14, 1938 (R. 22) and the property together with the outstanding mortgage was transferred to Joseph W. Ferris, George L. Long and Henry Leifert, trustees, respondents herein (R. 250).

The plan of reorganization for the Burnside Issue did not distinguish between rights of the Prudence trustees and other holders of certificates to participate in the proceeds of the trust estate. A question, however, arose as to the right of the Prudence trustees to share on a parity with other holders of certificates, in view of the fact that Prudence had guaranteed the payment of principal and

interest of the certificate issue. In order to avoid delay in the consummation of the plan, the plan was amended by agreement so as to provide that no distributions should be made thereunder on the Prudence-held certificates until the rights of such certificates were adjudicated by "a court of competent jurisdiction". This amendment to the plan was approved by the judge in charge of the proceeding in his order confirming the plan (R. 175). The order approving the amendments and confirming the plan did not separately classify the Prudence trustees (R. 163, 164).

The plan of reorganization for Prudence was confirmed by the District Judge in charge of that proceeding and of the proceeding for the reorganization of the Burnside Certificate Issue on May 26, 1939, ten months after the Burnside plan had been approved (R. 126). In accordance with its provisions, all of the assets of Prudence and its trustees were transferred and assigned to petitioner, the creditors' realization corporation, by assignment dated June 1, 1939. As is set forth in the order confirming the Prudence plan, there were outstanding obligations of Prudence aggregating $133,713,000 (R. 66). Of these claims only the claim of the United States of America for $400,000 has been fully paid.

Prior to the institution of the proceeding for the reorganization of Prudence and in June, 1932, all of the stock of its wholly owned subsidiary, Amalgamated Properties, Inc., had been deposited as part of the collateral for a loan made by Reconstruction Finance Corporation to Prudence. In 1938, in accordance with the decision of the Circuit Court of Appeals for the Second Circuit (*In re The Prudence Company, Inc.*, 90 F. (2d) 587), the ownership of that subsidiary of Prudence passed from the bankrupt estate to Reconstruction Finance Corporation. During 1940, as a result of negotiations between Reconstruction Finance Corporation and petitioner, a claim of petitioner against Amalgamated was assigned to a subsidiary of Reconstruction Finance Corporation in exchange for cer-

tain assets of Amalgamated. Upon the consummation of this compromise Reconstruction Finance Corporation's subsidiary became the sole creditor and stockholder of Amalgamated and sought the dismissal of the reorganization proceedings relating to Amalgamated since no reorganization was necessary. In order to accomplish such a dismissal it was necessary to close the proceedings for the reorganization of the several certificate issues which had been reorganized in the Amalgamated proceeding, including the Burnside Certificate Issue. For that reason, and that alone, an order was entered closing the Burnside Certificate Issue reorganization proceeding (R. 193-195).

In May, 1940, the trustee appointed as a result of a plan of reorganization for the Zo-Gale Certificate Issue, which also had been reorganized in the Amalgamated proceeding, started a proceeding in the federal court in the Amalgamated proceeding to determine the parity question which had been reserved in the Zo-Gale plan for adjudication by "a court of competent jurisdiction". That application had not yet been determined by the District Court. Under these circumstances the order dismissing the Amalgamated proceeding specifically reserved jurisdiction in the federal court with respect to the pending motion for the determination of the parity question in the Zo-Gale Issue (R. 195, 196).

The District Court's opinion in the *Zo-Gale* case was rendered on January 25, 1941, holding that the Prudence-held certificates were subordinated. The court there held that the law of the State of New York was controlling on the issue and that under such decision other holders of certificates were entitled to priority in the distribution of the proceeds of the Zo-Gale estate.

In August, 1941, the United States Circuit Court of Appeals for the Second Circuit affirmed by a divided court the decision of the District Judge in the *Zo-Gale* case (*Geist* v. *Prudence Realization Corporation*, 122 F. (2d) 503). This Court on January 5, 1942 granted a petition

for a writ of certiorari to the United States Circuit Court of Appeals in the *Zo-Gale* case, and on April 28, 1942 rendered its decision unanimously reversing the decision of the Circuit Court of Appeals in the *Zo-Gale* case, and held that the question of parity was one of federal law and that under the Bankruptcy Act petitioner, as representative of the creditors of the insolvent guarantor, was entitled to a position of parity with all other certificate holders (*Prudence Realization Corporation* v. *Geist*, 316 U. S. 89).

Immediately after the District Court decision was rendered in the *Zo-Gale* case, and on February 25 and 26, 1941, complaints were served upon petitioner by the trustees-respondents and by holders of Burnside certificates suing in a representative capacity, in actions for declaratory judgments instituted in the Supreme Court of the State of New York, County of New York, by which actions the plaintiffs sought to secure a determination that the certificates held by petitioner in the Burnside Certificate Issue were subordinated to certificates held by others. Answers were filed by other certificate holders seeking equivalent relief by cross-complaint against petitioner. Answers were interposed by petitioner which denied that the certificates held by it were to be subordinated and, further, urged as affirmative defenses that in view of the reorganization of the certificate issue and the guarantor in the federal court under the provisions of the Bankruptcy Act, the question of participation in the distributions of the proceeds of the Burnside Certificate Issue was a question of federal law as to which the provisions of the Bankruptcy Act and the federal decisions thereunder were controlling (R. 258-263). The actions were thereafter consolidated.

After this Court's decision in the *Geist* case, petitioner moved in the Additional Special Term of the Supreme Court of New York County for summary judgment (R. 11).

No issues of fact were presented and all parties agreed that the matter could be disposed of as a matter of law, the primary question being whether this Court's decision in *Prudence Realization Corporation* v. *Geist, supra,* was controlling or whether the decisions of the State of New York were binding (R. 322). As part of the record a deposition was taken of a witness called by respondents (R. 207, 321). The Justice at Additional Special Term denied the motion for summary judgment. Appeals were taken from the order entered upon that decision by all the interested parties and the Appellate Division of the Supreme Court of the State of New York, First Department, unanimously reversed the Special Term and held that where the certificate issue and the guarantor are reorganized in the federal court, the question of participation in the assets of the insolvent certificate issue is one of federal law and that under the decision of this Court in *Prudence Realization Corporation* v. *Geist, supra,* the certificates held by petitioner are entitled to parity with all other certificate holders (*Ferris, et al.* v. *Prudence Realization Corporation*, 266 App. Div. 343 [R. 343]).

Appeals were taken from the judgment entered upon that decision by the trustees-respondents and by City Bank Farmers Trust Company and Martin S. Lindgrove, etc., certificate holders. The New York Court of Appeals reversed the Appellate Division. It determined that the question of parity is a matter for the state court and determinable exclusively as a matter of local law. Upon that basis the New York Court of Appeals purported to distinguish this Court's opinion in *Prudence Realization Corporation* v. *Geist*, omitting, however, reference to the fact that the question of parity in that case similarly had been reserved for adjudication by "a court of competent jurisdiction" (R. 359).

Specification of Errors

The New York Court of Appeals erred

1. in holding that the certificates of participation in the Burnside Certificate Issue owned by Prudence Realization Corporation are not entitled to parity of distribution with certificates held by others but are subordinate to such certificates;

2. in holding that the question of parity was determinable as a matter of New York law;

3. in failing to hold that since the Burnside Certificate Issue and The Prudence Company, Inc., the guarantor, were reorganized in the federal court under Section 77B of the Bankruptcy Act, the question of parity was determinable as a matter of federal law;

4. in failing to hold that, in accordance with the provisions of the Bankruptcy Act and the decision of this Court in *Prudence Realization Corporation* v. *Geist*, 316 U. S. 89, Prudence Realization Corporation is entitled to share equally with other certificate holders in the proceeds of the Burnside Certificate Issue;

5. in holding that the plan of reorganization for the Burnside Certificate Issue contained no provision with reference to Burnside Certificate Issue certificates held by petitioner.

Reasons Relied On for the Allowance of the Writ

1. The decision of the New York Court of Appeals is in conflict with the decision of this Court in *Prudence Realization Corporation* v. *Geist*, 316 U. S. 89, and *Local Loan Co.* v. *Hunt*, 292 U. S. 234. In determining the right

to participation with respect to certificates held by petitioner, the state court has disregarded the effect of bankruptcy reorganization proceedings for the certificate issue and the insolvent guarantor. It has held that the participating rights of the insolvent guarantor's creditors in the proceeds of a certificate issue is a matter of local rather than federal law even though the guarantor and the certificate issue have been reorganized in the federal court under Section 77B of the Bankruptcy Act.

In the *Geist* case this Court held that federal and not local law was applicable to a determination of similar rights to those asserted by petitioner here. Petitioner in the *Geist* case and in the present one is the same corporation, asserting the same rights. The respondent in the *Geist* case was a certificate issue trustee holding a position identical with that of the trustee-respondents. In the *Geist* case the question of parity had been reserved similarly for adjudication by a "court of competent jurisdiction". The pertinent provisions of each plan are substantially identical:

PRUDENCE REALIZATION CORPORATION V. GEIST, SUPRA
Case on Appeal (R. 6)

"Some question has arisen with respect to the rights of The Prudence Company, Inc. on account of $816.67 of Certificates held or claimed by that Company and its Trustees, and question has also arisen with respect to the interest in said Mortgage (being the $7,200 principal amount thereof not represented by outstanding Certificates) owned or claimed by The Prudence Company, Inc. and its Trustees and/or by Prudence-Bonds Corporation and its Trustees."

FERRIS V. PRUDENCE REALIZATION CORPORATION
(R. 362, 363)

"A question has arisen with respect to the rights of The Prudence Company, Inc., or its Trustees on account of the certificates held or claimed by them, including so-called 'unissued certificates.'

UDENCE REALIZATION CORPORATION V. GEIST, SUPRA
Case on Appeal (R. 6)

nything in the Amended Plan the contrary notwithstanding, Trustee under the Amended n shall make no distributions cash and/or securities on ac- nt of the Certificates now d or claimed by The Prudence mpany, Inc. and its Trustees, on account of the part of said rtgage which is not repre- ted by outstanding Certifi- es, *unless and until it shall e been finally adjudicated by ourt of competent jurisdiction* t The Prudence Company, Inc. l its Trustees and/or Pru- ce-Bonds Corporation and its ustees are entitled to share in trust estate by reason there- (Italics supplied.)

FERRIS V. PRUDENCE REALIZATION CORPORATION
(R. 363)

"Anything in the Plan to the contrary notwithstanding, the Trustees to be appointed hereunder shall make no distributions of cash or other property or securities which would be otherwise distributable on account of the certificates now held or claimed by The Prudence Company, Inc., or its Trustees, including said 'unissued certificates,' *unless and until it shall have been finally adjudicated by a Court of competent jurisdiction* whether or not The Prudence Company, Inc. or its Trustees, or their successors or assigns, are entitled to receive such cash or other property or securities and to share in the proceeds of the property to be assigned to the Trustee pursuant to the Plan and on a parity with other certificate holders or otherwise." (Italics supplied.)

In each case the litigation was instituted some time after consummation of the certificate issue plan. The sole dissimilar feature is that in the *Geist* case the trustees appointed under the plan instituted the proceedings in the federal court before the closing of the certificate issue reorganization proceeding, and in the present case the trustees instituted the proceedings in the state court after the closing of the federal proceeding.

It is apparent that the intent of the parties and of the reorganization court in each of these cases was the same; that there was no intent in either case to waive any right to adjudication of the question as a matter of federal law; that the phrase "court of competent jurisdiction"

meant no more than that phrase can mean at any time—any court having jurisdiction of the parties and of the subject matter.

As a basis for rejecting the decision of this Court in the *Geist* case, the state court relied on the fact that in the Burnside plan the question of parity had been reserved for adjudication "by a court of competent jurisdiction", and said at page 218 (R. 366):

> "Upon this record it appears without contradiction that the Burnside plan of reorganization did not attempt to define or determine the relative rights of Realization Corporation as the holder of certificates acquired by Prudence and of other holders of Burnside certificates, nor was any determination of these rights made in the Bankruptcy Court in the course of its administration or in connection with the distribution of any of the assets either of Prudence or of Amalgamated. The controversy, therefore, was brought to the state courts, as contemplated by the plan of reorganization, for determination of these relative rights unaffected by the reorganization in the Federal court."

But, as has been indicated, in the *Geist* case the question of parity similarly was reserved for adjudication "by a court of competent jurisdiction" and the adjudication there resulted from an application made pursuant to that reservation. The state court placed great stress upon the fact that in the *Geist* case the question was determined in the reorganization proceeding. It disregarded the fact that the parity question could have been determined similarly in the Burnside reorganization proceeding pursuant to the same reservation.

In the *Geist* case, the question was not determined by the plan nor by any administrative order. The proceeding for its determination was instituted by the trustee appointed under the plan after the plan's consummation. At the time of the institution of the proceeding the property was being administered by such trustee outside the

bankruptcy court. Since the question had been reserved as part of the plan's confirmation, this Court considered the question as it existed at the time of reservation—a matter of distribution of the proceeds of a certificate issue which had been reorganized in the federal court, among certificate holders including representatives of creditors of an insolvent guarantor being reorganized for its creditors' benefit in the federal court. The status of the parties in the present case at the time of the reservation was the same as it was in the *Geist* case, and the subsequent closing of the Amalgamated proceeding did not alter that status nor relieve the state court from its obligation to determine the issue as a federal question.

The New York Court of Appeals, however, has interpreted the reservation as a waiver of the right to secure an adjudication of the question as a federal question and, further, as authority for the state court to disregard the federal reorganization of the certificate issue, the bankruptcy of the guarantor and the rights of the insolvent guarantor's creditors under the Bankruptcy Act.

The fact that the reservation gives to any court having jurisdiction of the parties the right to determine the parity question does not negative the requirement that such court apply federal law in determining a federal question (*Lucotin* v. *Atlas Exchange Bank*, 295 U. S. 209). Nor may the rights secured to the Prudence creditors by the Bankruptcy Act be abrogated by the state court merely because the litigation proceeds in that court through the choice of the plaintiffs.

This Court has protected by injunction a discharged bankrupt from the resultant hardship of an unwarranted judgment which would violate the purpose and spirit of the Bankruptcy Act.

In *Local Loan Co.* v. *Hunt*, 292 U. S. 234, an assignee of future wages instituted suit in the Illinois state court against the employer of a debtor who had received a discharge in bankruptcy. The bankrupt sought an injunc-

tion in the federal court restraining the judgment-creditor from proceeding with his state court action on the ground that by its prior decisions the Illinois court had demonstrated that it would refuse to give effect to the discharge in bankruptcy and would permit the action to proceed to judgment.

In considering the competency of the state court's jurisdiction this Court said at p. 241:

> "So far as appears, the municipal court was competent to deal with the case. * * * And it may be conceded that the municipal court was authorized in the law action to afford relief the equivalent of that which respondent now seeks in equity."

In sustaining the injunction, however, this Court held that a state court would not be permitted to enter a judgment which would violate the purpose or spirit of the Bankruptcy Act. After pointing out that one of the purposes of the Bankruptcy Act was to give to an honest but an unfortunate debtor a new opportunity unhampered by the pressure and discouragement of pre-existing debt, this Court said at p. 245:

> "The various provisions of the Bankruptcy Act were adopted in the light of that view and are to be construed when reasonably possible in harmony with it so as to effectuate the general purpose and policy of the act. Local rules subversive of that result cannot be accepted as controlling the action of a federal court."

The present case comes squarely within the decision of this Court in the *Local Loan Company* case. The Bankruptcy Act, Section 65(a), requires that in liquidations, distribution of dividends of an equal percentum shall be made in all allowed claims except such as have priority or are secured (*Prudence Realization Corporation* v. *Geist*, *supra*; *Globe Bank* v. *Martin*, 236 U. S. 288, 305; *Moore* v. *Bay*, 284 U. S. 4). This purpose of the Bankruptcy Act,

avoid preferences, is the object similarly of protection the federal court. Here the state court has refused to ve effect to these express provisions of the Bankruptcy t and the decisions of this Court interpreting such pro-sions in construing a federal plan of reorganization, and is submitted is similarly subject to reversal by this urt as violative of the purpose of the Bankruptcy Act.

2. The result of the present decision is to grant a prefer-ce to Burnside certificate holders unauthorized by the nkruptcy Act and in conflict with the decisions of this urt.

In *Prudence Realization Corporation* v. *Geist*, at p. 97, s Court said:

> "The Prudence Company, Inc. is not solvent. Its property is being liquidated in bankruptcy where all the claimants on its present and other guaranty obligations are entitled to share equally in its unpledged assets. Denial of the right to prove its claim, which is an asset in which all of Prudence's creditors are otherwise entitled to share, will serve only to divert this asset from all creditors to one class of creditors, the Zo-Gale certificate holders, and thus give to them the exclusive benefit of a security for which they have not bargained."

The New York Court of Appeals, by holding petitioner's ificates subordinate, has effectively accomplished what Court held to be improper, for the Burnside certificate lers thus far have been granted the exclusive benefit the Burnside mortgage at the expense of all other dence creditors including the Zo-Gale certificate holders, se claim for a similar preference was denied by this rt in the *Geist* case:

> The New York Court of Appeals has decided a fed-question of substantial importance in a manner which result in confusion in the administration of federal

laws in the federal and state courts. The state court has held that the identical question which this Court held to be a question of federal law in the *Geist* case becomes a question of local law merely because the proceeding was instituted in the state court subsequent to the closing of the reorganization proceeding. In the *Geist* case, however, the parity question was held to be a matter of federal law because the participation of creditors was regulated by the Bankruptcy Act. The institution of the reorganization proceedings crystallized the rights of creditors. Wherever those rights finally are adjudicated, that adjudication necessarily must be had on the basis of the laws by which those rights were affected and regulated. Thus it should make no difference whether the adjudication is had in the federal or state courts. If the question as held in the *Geist* case was a federal question, it continues to be a federal question even though the litigation for its adjudication takes place in the state court.

It must be conceded that had the litigation of the Burnside parity question been instituted in the federal court after the consummation of the federal plan, as was true in the *Geist* case, the federal rule would be applicable. It is solely because respondents elected to sue in the New York court that such tribunal has had the opportunity to make an adjudication and has accepted such opportunity and applied its local rule admittedly inconsistent with the federal law.*

The determination by the New York Court of Appeals here has been interpreted as indicating that the New York courts may disregard federal decisions where inconsistent with their own.

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* As illustrative of the effect sought to be given to the New York Court of Appeals decision in the present case, that decision has been cited in a federal reorganization proceeding, in which petitioner is interested as a party, as authority for the proposition that the determination of the status of petitioner's certificates is a question of state rather than federal law. *(In the Matter of 1934 Realty Corp., Debtor*, Chap. X proceedings No. 72805, U. S. D. C., S. D. N. Y.)

Hon. Orrin G. Judd, Solicitor-General of the State of New York, in reviewing outstanding decisions of the New York Court of Appeals for the past twelve months, said:

> "Another application of this principle of undivided loyalty may be found in a case like Ferris v. Prudence Realization Corporation, decided last month (Law Journal, April 7, 1944), in which the court adhered to its rule that a guarantor which reacquires mortgage certificates after default is subordinated to the claims of other certificate holders, even though the question arose under the Prudence Company reorganization plan, where the United States Supreme Court had previously decided that as far as the rights in the federal reorganization court were concerned the guarantor was on an equal status with other certificate holders (Prudence Realization Corp'n v. Geist, 316 U. S. 89). So it seems that in spite of Thompson (*sic*) v. Erie Railroad (304 U. S. 64), there are still situations where the state and federal courts will reach different results on the same state of facts" (New York Law Journal, May 18, 1944, p. 1926).

As further indication of the interpretation which will be given to the decision of the New York Court of Appeals, reference is made to a note in the United States Law Week, where, in referring to the decision of the New York Court of Appeals, the following statement appears:

> "'Prudence v. Geist' Rule Delimited.
>
> * * * * * *
>
> "The principle of the Geist case, the court declares, applies only if a federal bankruptcy court either approves a reorganization plan containing a provision determining the interests of holders and guarantor of the mortgage participation certificates or issues an order regulating their interests" (U. S. Law Week, April 4, 1944, 12 L. W. 1152).

The uncertainty of the effect of the decision is apparent and unless clarified by this Court will result in continued litigation in federal and state courts, presumably on a competitive basis. The present confusion exists despite

this Court's affirmation of the *Geist* decision in *Sola Electric Co.* v. *Jefferson Electric Co.*, 317 U. S. 173, 176 (cited as controlling by the Appellate Division in the instant case [R. 343]), and *Wragg* v. *Federal Land Bank of New Orleans*, 317 U. S. 325, 328, which were cited to the New York Court of Appeals in the instant case and ignored by that court.

If the forum of litigation is conclusive on the question as to whether federal or state law is applicable, it is submitted that future litigants should be so informed by this Court. If, however, rights granted by federal statute will be assured protection regardless of the forum in which their adjudication is sought, it is respectfully submitted that a present statement of such assurance is necessary to obviate the confusion created by the New York Court of Appeals.

Conclusion

WHEREFORE, it is respectfully submitted that this petition for a writ of certiorari to the Supreme Court of the State of New York, County of New York, should be granted to review the judgment and order of the New York Court of Appeals and the judgment entered thereon in the Supreme Court of the State of New York, County of New York, and the said judgments should be reversed.

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June, 1944.